

C O N F I D E N T I A L

BRUSSELS 00031

BRUSSECX:

ACTION: UECON

INFO: UAID UAMB UCUST UDCM UFCS UNAS UPAO UPOL UPRM
UAGR DCM

DISSEMINATION: UECON

CHARGE: USEU

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RR RHEHNSC RUEHC RUEHZN RUCNMEU RUCNMEM RUEHAK
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TO RHEHNSC/NSC WASHDC
RUEHC/SECSTATE WASHDC
INFO RUEHZN/ENVIRONMENT SCIENCE AND TECHNOLOGY COLLECTIVE
RUCNMEU/EU INTEREST COLLECTIVE
RUCNMEM/EU MEMBER STATES COLLECTIVE
RUEHAK/AMEMBASSY ANKARA
RUEHKB/AMEMBASSY BAKU
RUEHCH/AMEMBASSY CHISINAU
RUEHKV/AMEMBASSY KYIV
RUEHSK/AMEMBASSY MINSK
RUEHMO/AMEMBASSY MOSCOW
RUEHNY/AMEMBASSY OSLO
RUEHSI/AMEMBASSY TBILISI
RUEKJCS/DOD WASHDC
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C O N F I D E N T I A L SECTION 01 OF 02 BRUSSELS 000031

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TAGS: [ECON](#) [EPET](#) [EUN](#) [RS](#) [UP](#)

SUBJECT: RUSSIA/UKRAINE: PIEBALGS SEES SHADOW, PREDICTS
LONG WINTER

REF: A. BRUSSELS 13 B. BRUSSELS 6

Classified By: By EEST Chief Louis L. Bono for reasons 1.4(b) and (d).

¶1. (C) Summary: EU Energy Commissioner Andris Piebalgs told Ambassador Silverberg January 9 that Russia and Ukraine agreed to accept an "international" monitoring team to restore gas deliveries through Ukraine to Europe. Gas flows should resume by Saturday, January 10. Piebalgs remains concerned as the agreement resuming the gas could fall apart immediately and will surely collapse if Russia and Ukraine do not have a contract by the time Ukraine's gas reserves run out. End summary.

DESTINED TO FAIL

¶2. (C) Piebalgs said that Russia and Ukraine had agreed to an approach that would allow gas flows to resume to the EU. In particular, both countries will accept an "international" monitoring team made up of EU officials and gas company representatives to monitor the flows of gas from Russia, into Ukraine and from Ukraine to Europe. Ukraine will have monitors on the teams in Russia; Russia will be represented in the teams in the Ukraine. The EU teams are already in place in Ukraine and should be in Russia shortly. With this agreement on monitors, gas flows are expected to resume, Piebalgs expects no later than Saturday.

¶3. (C) Piebalgs said the agreement is very fragile, because it does not allow any gas to go to Ukraine, even as it transits to Europe. The Ukraine compressors need to be primed with gas to pump gas through the system. "Where will this gas come from? They will have to use gas destined for Europe." (Note: Ukraine claims that the transit fees do not cover the costs to run the compressors to transit gas through to Europe. End note.) And with Russian monitors in Ukraine, Russia could accuse Ukraine of stealing gas on the first day. The Ambassador asked how the EU would respond if Russia accused the Ukraine of diverting gas for technical reasons.

He said they would explain the problem but otherwise demurred. Piebalgs had asked Gazprom Chief Alexei Miller "who will pay for the compressor gas." Miller did not answer. Piebalgs took this to mean that Gazprom does not see this as an issue now.

¶4. (C) Further, a Russian customs law prohibits the export of gas without an agreement. Gazprom used this law to justify delivery suspensions following the expiration of its supply contract with Ukraine. Until a contract for sales for domestic use in Ukraine is renewed, any deliveries consumed by Ukraine for compressors could be illegal under Russian law.

¶5. (C) Finally, even if Russia does not cry foul over gas for the compressors, if a sales agreement is not reached between the two, Ukraine's reserves will eventually run out. He said then Ukraine "without hesitation will take out from European supplies." And Piebalgs is not optimistic that a new sales agreement will be reached. Ukraine hopes that it can negotiate a better deal on transit fees to compensate for the price increase that Gazprom is demanding. Miller, on the other hand, is intransigent and will not change the transit fee structure until the current contract runs out in 2013. Gazprom, Miller suggested to Piebalgs, could take over the transit arrangements, but Piebalgs said this will "never fly".

¶6. (C) As a result, any new bilateral sale agreement will have to be based on the existing transit agreement) "they're stuck with it." With gas and oil prices down, there "was a good chance for a long-term agreement, but that is gone now." Piebalgs predicted it would only take a matter of weeks, before Ukraine would need fresh supplies. Then, the whole deal will "backfire". Ambassador Silverberg asked what the EU's contingency plan was, but Piebalgs did not have an answer. (Note: Emb Kyiv reports Ukraine claims to have enough gas in storage to last for three months. End note.)

THE CIRCUS COMES TO TOWN

¶7. (C) Piebalgs also described the process leading up to the January 8 discussions. Following the cut-off of deliveries on January 6, talks "were completely dead". On January 7, Commission President Jose Manuel Barroso called Russian Prime Minister Vladimir Putin and encouraged him to send a delegation to Brussels. (Note: Up to this point, the EU declared that it did not intend to mediate the dispute or send monitors. End note.) Later that day, Piebalgs spoke with Russian Energy Minister Sergei Shmatko who agreed to a trilateral meeting with Ukraine. Piebalgs said this was necessary as the Ukraine system was at risk of collapsing. However, he believed that the Russians sought to use Brussels as a stage to "point the finger" at Ukraine.

¶8. (C) The following day, Miller refused a joint meeting with the Ukraine delegation. Miller told Piebalgs that Ukraine Prime Minister Tymoshenko was prepared to endorse an agreement reached between Gazprom and Naftogaz, but President Yushenko vetoed it. He presented Piebalgs with a draft protocol outlining the terms for EU observers. The Ukraine delegation, led by Deputy Prime Minister Nemyrya and Naftogaz Chief Dubyna initially opposed Miller's proposal, seeking instead an EU-Ukraine agreement on monitors. After the Ukraine delegation relented, Piebalgs reconvened with Miller who insisted for the first time on Russian monitors. Piebalgs said this would have to be taken up with the Ukrainians and the talks ended. At this point Ukraine insisted on including its monitors in the delegation. Miller called Piebalgs later and said Russia would reciprocate and "give access to Ukrainian monitors if they really need it."

¶9. (C) Piebalgs admitted that he was prepared to mediate the dispute. He did not, however, want to send monitors, as he believes that relieving the pressure on Europe removes the leverage for a more lasting settlement between Russia and Ukraine. This he described as "another fatal flaw" in this tenuous agreement. Further, for the international monitors, there is no clear mandate, no leader, and their presence is "not really binding". (Piebalgs said what would normally be

104 pages of text on monitors was set forth in four sentences.) The monitors will operate on both sides of the border, but the mandate in Ukraine is broader than in Russia.

Thus, he predicts the GoU will eventually balk at the arrangement. Piebalgs is also concerned there is no exit strategy for the EU team. He fears that EU monitors will be seen as "depriving Ukrainian households of gas" when Ukraine's reserves run out. He believed he could have structured a better deal if he could have brought the sides together.

¶10. (C) More significantly, Piebalgs lamented: "for the first time in my experience with Gazprom, the customer didn't matter." The Russians were more focused on punishing Ukraine than they were on their reputation as a reliable supplier. Nonetheless, "it is naive to say we won't continue to buy gas from Russia."

LOOKING FORWARD

¶11. (C) In the longer term, Piebalgs fears a future in which Europe will depend on flows from Iran and Russia: He noted the heightened importance on the Southern Corridor and the challenges therein. (See septel.) He added "we need to get away from natural gas and focus on renewables and efficiency." This crisis also opened his eyes to the need to mandate member states keep gas stocks. Piebalgs believes Bulgaria was partially to blame for its plight because it was dependent on one supply route and had minimal reserves. He intends to propose security of supply legislation for the incoming Commission and Parliament.

COMMENT: DEJA VU AGAIN

¶12. (C) Two things are clear from Piebalgs' remarks. Even if gas does begin flowing to the EU again on Saturday, that arrangement is at best tenuous and can fall apart whenever Russia decides to contest Ukraine's diversions for the compressors. More significantly, even if no further problems arise in deliveries to the EU, Ukraine is in a worse bargaining position now than it was in November. The monitors are there to ensure Europe gets its gas; if Ukraine does not reach agreement with Gazprom it either goes cold when its domestic stores run out or it diverts the EU's gas and is labeled the culprit. We see a good chance this will happen: Gazprom has no reason to agree to an increase in the transit prices until the existing agreement ends in 2013, and it can "reasonably" request Ukraine to pay "market" prices, both conditions unacceptable to Ukraine. The U.S. and the EU could then be put in the difficult position of seeing Ukraine put under significant pressure or arguing on its behalf for less than market price. We should begin working with the Europeans now to figure out a response to this contingency, since it may well come sooner than we think.

Silverberg

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